



STATE OF TENNESSEE

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May 5, 2003

MEMORANDUM

TO: The Honorable Phil Bredesen
Governor

The Honorable Douglas Henry, Chairman
Senate Finance, Ways and Means Committee

The Honorable Tommy Head, Chairman
House Finance, Ways and Means Committee

FROM: Steve Adams
State Treasurer

Riley Darnell
Secretary of State

M.D. Goetz, Jr.
Commissioner of Finance & Administration

John Morgan
Comptroller of the Treasury

SUBJECT: Revenue Estimates

The State Funding Board met on April 28, 2003 to hear presentations and engage in discussions about the State's near-term economic outlook and estimates of State tax revenue collections for the fiscal years 2002-03 and 2003-2004. Presenters included Mr. Jim Davenport of the Fiscal Review Committee and Dr. William Fox of the University of Tennessee. In addition, Mr. Reid Linn of the Department of Revenue was in attendance and provided responses to questions by the Board. The Board was also briefed on the preliminary results of state tax collections for April, 2003. A spreadsheet that summarizes the State tax revenue estimates as presented is attached to this memorandum (Attachment 1 for FY 2002-03 and Attachment 2 for FY 2003-04).

With regard to the economy, the consensus continues to be that the economy is entering a recovery phase, with the economy in 2003 and 2004 likely to be better than 2001 or 2002. On the positive side, the Iraq conflict appears to be coming to a close, stronger capital spending is being forecast, inflation remains in check, productivity remains strong, and consumer confidence is improving from current low levels. Threats to a continued recovery include an outlook for weak corporate profits in the near term and weak employment growth.

With regard to specific taxes, the following observations are offered.

Sales Tax. The sales tax has performed better than estimates for six of nine months during the fiscal year, and in five of the last six months. This tax is currently on track to meet the original July, 2002 estimates. This appears consistent with current economic data indicating improving consumer confidence.

Franchise & Excise Tax. Based on preliminary reports of collections in April 2003, the combined franchise and excise tax appears on track to meet the original July, 2002 estimates.

Income Tax. Approximately 80% of the budgeted value of the income tax is estimated to be collected in April, 2003. Based on preliminary reports of collections in April 2003, the income tax will under collect both the original and revised estimates for the current fiscal year, reflecting continued poor performance by the investment markets.

Business Tax. Approximately 80% of the budgeted value of the business tax is estimated to be collected in June, 2003. For the first 9 months of this fiscal year, the tax has met estimates only once. It is believed that, due to implementation issues, this tax will under collect both the original and revised estimates during the current fiscal year.

Inheritance & Estate Tax. Testimony before the Board indicated the estimates of revenue from these taxes did not include the impact of enactment of federal tax legislation phasing out the estate tax credit. Estimates of the impact of failure to “de-couple” from these federal tax changes ranged from revenue decrease of \$2.5 million to \$6.35 million for FY 2002-03 and \$2.5 million to \$9.52 million for FY 2003-04.

Based upon the presentations made and resulting Board discussion, the Board determined to confirm its previously adopted consensus revenue estimate ranges. The following table summarizes these estimates:

	<u>FY 2002-03</u>		<u>FY 2003-04</u>	
	<i>Low</i>	<i>High</i>	<i>Low</i>	<i>High</i>
Total State Taxes	12.45 %	12.95 %	2.50 %	3.00 %
General Fund Only	15.40 %	15.90 %	2.60 %	3.10 %

In conclusion, for FY 2002-03, the Board believes the previously adopted ranges continue to be reasonable, with final results likely to fall close to the mid-point of the range. For FY 2003-04,

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the Board continues to believe the previously adopted ranges are reasonable and that an estimate of revenue growth falling within these ranges should be considered reasonable.

We will be happy to discuss these matters with you further at your convenience.

Attachment

cc. The Honorable John S. Wilder
 The Honorable Jimmy Naifeh